

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF SUBURBAN	)	
MORTGAGE ASSOCIATES, INC., SUCCESSOR	)	CASE NO. 7949
TO FORDHAVEN, INC.	)	

O R D E R

On August 29, 1980, Suburban Mortgage Associates, Inc., ("Applicant") and its subsidiary, Fordhaven, Inc., a wholly owned and operated corporation engaged in the operation of a sewage disposal plant and maintenance of a sanitary sewage system, filed a petition with the Public Service Commission (formerly the Utility Regulatory Commission) seeking to increase its rates for services rendered. Applicant provides service to approximately 80 single-family residences and some 216 apartmental units, all in Jefferson County, Kentucky. Applicant cites increased costs of operation, inflation, more stringent controls imposed by the regulatory agency, lack of funds for replacement of necessary and essential equipment, and increases in collection charges by the Louisville Water Company as reasons for additional funds.

On December 9, 1980, Applicant filed an amended petition updating its financial exhibits and setting forth its proposed rates pursuant to the Commission's regulations. The proposed rates would increase residential bills approximately 13% and apartment bills approximately 19%.

The Commission in an Order dated September 11, 1980, set a public hearing to be held on December 23, 1980, at its offices in

Frankfort, Kentucky. Notice of such hearing was made by Applicant pursuant to the Kentucky Revised Statutes and the Commission's regulations. A public hearing in this matter was held as scheduled with the Consumer Intervention Division of the Attorney General's Office being the only party to intervene. Applicant has responded to all requests for information and the record in this matter is now considered to be fully submitted for final determination by this Commission.

#### TEST PERIOD

For purposes of testing the reasonableness of the proposed rates and charges, the Commission has adopted the twelve months ended October 31, 1980, as the test period. Adjustments, when proper and reasonable, have been included to more clearly reflect current operating conditions.

#### REVENUES AND EXPENSES

Applicant proposed several adjustments to its operating revenues and expenses to more closely reflect pro forma operating conditions. The method applied by Applicant in determining the adjustments to operating expenses was based on increasing variable expenses by the ratio of plant capacity to used capacity. This method is not considered appropriate as the Commission is of the opinion that it is speculative during periods of ever changing economic conditions. The Commission finds that a more appropriate method is to adjust fixed costs and leave variable costs at current levels when appropriate. Therefore, the Commission has disallowed Applicant's adjustments to reflect maximum plant capacity.

Applicant proposed only one other expense adjustment, that being rate case expense. The adjustment has been accepted as proposed.

Further, the Commission has made the following adjustment to the test period level of operating expenses:

(1) Fuel and power costs for the test period were \$7,248. In reviewing the record of this matter, invoices of electric costs indicate that \$311 was carried forward as an unpaid balance from outside the test period and later paid during the test period. This amount has been disallowed from the test period fuel and power costs, decreasing fuel and power costs to \$6,937.

(2) Applicant proposed depreciation expense based on an average service life of ten years. The Commission is of the opinion that for rate-making purposes, average service life should be 20 years. Therefore, Applicant's test period depreciation expense has been reduced \$96.

(3) Interest expense for the test period was \$7,798, including \$5,163 on long-term debt, \$2,613 on debt to associated companies, and \$22 other interest<sup>(1)</sup>. Further, the record in this matter shows only depreciation expense for current additions and improvements<sup>(2)</sup>. Upon questioning at the hearing as to why there was debt but no depreciable property, Applicant responded that for tax purposes, sewer plant had been written off and charged against the lots at the time the lots were sold<sup>(3)</sup>. Testimony of Applicant's witness also provides evidence that during the development stages of this utility,

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(1) Applicant's Amended Exhibit A, page 8

(2) Ibid.

(3) Transcript of Evidence, response 3, page 14

several notes were obtained for construction of various phases of the utility and surrounding service area. Applicant stated that the proceeds from the sale of these lots were applied to the other construction notes and not the treatment plant note<sup>(4)</sup>. Therefore, the Commission is of the opinion that, since Applicant was allowed to write off the sewer plant for tax purposes and since the allocation and repayment of debt between the development operations and the sewer operations were not made in the manner they would have been in an arms length transaction, interest expense on long-term debt should be disallowed. The record of evidence further shows that the \$5,163 shown as interest expense on long-term debt was inclusive of property taxes and insurance. Upon further examination, property taxes and insurance was found to be \$302, and this amount was subsequently transferred to operating expenses. Thus, Applicant's interest expense has been reduced \$4,861.

Including the above adjustments, Applicant's test period has been adjusted as follows:

	<u>Actual</u>	<u>Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$ 21,277	\$ 2,235 <sup>(5)</sup>	\$ 23,512
Operating Expenses	<u>19,643</u>	<u>795</u>	<u>20,438</u>
Net Operating Income	\$ 1,634	\$ 1,440	\$ 3,074
Interest Expense	<u>7,798</u>	<u>(5,163)</u>	<u>2,635</u>
Net Income	<u>\$ (6,164)</u>	<u>\$ 6,603</u>	<u>\$ 439</u>

#### REVENUE REQUIREMENTS

The Commission has used the operating ratio method as the basis in determining sewer rates for the past several years and finds that the results of this method have been reasonable and fair to both owners

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(4) Transcript of Evidence, response 14, page 48

(5) Normalization of end-of-period customers with existing rates

and ratepayers. The operating ratio method as used by the Commission is as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Operating Revenues}}$$

The Commission is of the opinion that a fair, just and reasonable operating ratio is .88 in that it will permit Applicant to pay its operating expenses, service its debt and provide a reasonable return to Applicant's owners. Therefore, the Commission finds that Applicant is entitled to increase its rates to produce total revenues of \$26,748<sup>(6)</sup> or an increase in revenues of \$3,236.

#### SUMMARY

The Commission, after consideration of the evidence of record and being fully advised, is of the opinion and finds that:

(1) The Applicant has filed with this Commission a valid third-party beneficiary agreement.

(2) The rates and charges prescribed and set forth in Appendix A are the fair, just and reasonable rates to charge for sewer service rendered by Applicant, in that based on test period conditions, revenues of \$26,748 will be produced.

(3) An operating ratio of .88 is fair, just and reasonable in that it should permit Applicant to pay its operating expenses, meet its debt service requirements and maintain an adequate surplus.

(4) The rates as proposed by Applicant and set forth in its amended petition would produce revenues in excess of those found to be reasonable herein and, therefore, must be denied upon application of KRS 278.030.

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(6) Includes income tax expenses of \$781

IT IS THEREFORE ORDERED that the rates and charges set forth in Appendix A are fair, just and reasonable for sewer service rendered by Fordhaven, Inc., on and after the date of this Order.

IT IS FURTHER ORDERED that the rates and charges proposed by Applicant and set forth in this amended petition, insofar as they differ from those in Appendix A, shall be and are hereby denied.

IT IS FURTHER ORDERED that Applicant shall file with this Commission within 30 days from the date of this Order its current rules and regulations and its revised tariff sheets setting forth the rates and charges approved herein.

Done at Frankfort, Kentucky, this 15th day of June, 1981.

PUBLIC SERVICE COMMISSION

Marlin M. Voh  
Chairman

Did not participate  
Vice Chairman

Don Harigan  
Commissioner

ATTEST:

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Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE  
COMMISSION IN CASE NO. 7949 DATED JUNE 15, 1981.

The following rates are prescribed for the customers in the area served by Surburban Mortgage Associates, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

<u>Customer Category</u>	<u>Monthly Rate</u>
Single-Family Residential	\$9.50
Multi-Family Residential	7.00